

Ellerston Australian Small Companies Fund

PERFORMANCE REPORT February 2018

The Ellerston Australian Small Companies Fund employs an active research driven investment approach to identify a portfolio of 30 - 60* small company securities which aims to deliver returns superior to the S&P/ASX Small Ordinaries Accumulation Index over time.

Ellerston Australian Small Companies Fund Performance

Return %	Net [^]	Gross	Benchmark	Net Alpha	Gross Alpha
1 Month	-0.50%	-0.45%	0.03%	-0.54%	-0.48%
3 Months	6.65%	6.86%	2.67%	3.98%	4.19%
Rolling 12 Months	19.53%	21.09%	20.81%	-1.28%	0.27%
2 Years p.a.	19.33%	20.46%	18.78%	0.55%	1.68%
3 Years p.a.	11.73%	13.06%	10.81%	0.92%	2.25%
Since Inception p.a.	11.41%	12.91%	9.00%	2.41%	3.91%

Ellerston Australian Small Companies Fund Top Holdings

Top 5 Stock holdings as at 28 February 2018	Sector	%
Cleanaway Waste Management Ltd	Industrials	5.96%
Austal Ltd	Industrials	3.99%
Speedcast International Ltd	Telecommunication Services	3.64%
Tox Free Solutions Ltd	Industrials	3.48%
Tassal Group Ltd	Consumer Staples	3.18%

[^] The net return figure is calculated after fees & expenses. The gross return is calculated before fees & expenses. Past performance is not a reliable indication of future performance

The benchmark is the ASX Small Ordinaries Accumulation Index. The Fund commenced on 10 October 2013.

*This is the typical number of stocks in the portfolio. The Information Memorandum does allow for 20 - 60 stocks.

Commentary

The Ellerston Small Companies Fund fell 0.50% in February, underperforming the ASX Small Ordinaries Accumulation Index which rose 0.03%. During the month, the Small Industrials Accumulation Index fell 0.08% whilst the Small Resources Accumulation Index rose 0.42%.

The largest contributors to positive attribution were WiseTech Global (WTC), Cleanaway Waste Management (CWY) and Here, There & Everywhere (HT1). Wisetech reiterated FY18 revenue guidance at its 1H18 result, which implied slower organic growth once taking recent bolt-on acquisitions into account. The update was therefore essentially an underlying revenue outlook downgrade. However, despite a 30% fall in the share price, Wisetech continues to trade at an elevated 11x FY19 EV/revenue. We do not own the stock. After falling steadily into the first half result, Cleanaway rebounded as earnings exceeded market expectations. This has now been a clear trend for the last 18 months after 9 years of continual downgrades. We still think that the market is underestimating the earnings outlook over the next 3 years as Cleanaway integrates Tox Free and benefits from scale it receives in the Liquids Waste market. We took the opportunity to increase the weighting in the stock during the weakness of early February. Here, There & Everywhere staged a bit of a relief rally on their full year result, which was in line with expectations. Radio, after having a year of losing advertising dollars to TV, should perform better in 2018 as TV share of market stabilises. The challenge remains in Adshel, in terms of replacing the lost earnings from the Yarra Trams contract which could take a couple of years. The company remains cheap on all measures, even with the ATO tax issue, and would be a prime candidate if any consolidation occurs in the media sector post the legislative changes late last year on ownership.

The largest detractors from relative returns were CBL Corp (CBL), Altium (ALU) and Nine Entertainment Co (NEC). CBL went into a trading halt in early February after announcing an FY17 profit downgrade, due to significant claims reserve strengthening. Trading was suspended pending asset sales and recapitalisation plans until its NZ regulator moved to install an interim liquidator to CBL's NZ insurance subsidiary. Following this, the CBL board appointed a voluntary administrator on 26-Feb. We are currently waiting for further information on how the restructure will proceed. Altium reported stronger than expected 1H18 revenue growth, management reiterated their long-term 2020 revenue growth target and upgraded underlying organic growth expectations. The current growth momentum suggests the company is tracking ahead of its 2020 target, however Altium's valuation remains stretched at 12x FY19 EV/revenue and 42x FY19 P/E. We do not own Altium or Nine Entertainment Co.

Outlook

The recently completed "reporting season" showed a heightened level of share price volatility, partially reflecting the very high multiples that some stocks have reached and the lack of broad based EPS growth in the market. According to most broker reviews of the reporting period, EPS revisions downwards outweighed upward revisions. Market returns for the financial year remain strongly positive with the Small Cap Index up 18% predominantly driven by PE re-ratings rather than earnings growth. In this strong pricing environment our returns have lagged the index mostly because we have not owned any of the Top 10 performing stocks which have accounted for 2/3rds of the markets return. Going forward it is looking less likely that the market will receive the EPS growth that is required to justify the PE re-rating the market has had and therefore we are expecting lower returns over the next year. This has typically led to greater alpha opportunities than during a rapidly rising market.

About the Ellerston Australian Small Companies Fund

The Fund employs an active, research-driven investment approach which seeks to identify a portfolio of smaller company securities with the aim of delivering superior returns to the Benchmark over time.

The Fund will invest in companies that are believed to have the potential to deliver significant upside over the medium term and where there is a reasonable margin of safety to mitigate the downside risk. We will actively manage the positions of the Fund.

Investments will generally be made in companies that have a sound business franchise with an attractive earnings profile, that operate in growth industries and trade at a discount to valuation.

Fund Facts

Strategy Funds Under Management	\$741 Million
Total number of Stocks	50
Application Price	\$1.1894
Redemption Price	\$1.1834
Inception Date	10 October 2013

Disclaimer

Returns are unaudited estimates and before fees and expenses and assume distributions have been reinvested. Past performance is not indicative of future performance. This letter does not constitute an offer of any Units in the Fund. This letter does not take into account your investment objectives, financial situation or particular needs. Before making an investment decision about the Fund, persons should read the information memorandum which can be obtained from Ellerston Capital and obtain advice from an appropriate financial adviser. This material has been prepared based on information believed to be accurate at the time of publication. Assumptions and estimates may have been made which may prove not to be accurate. Ellerston Capital undertakes no responsibility to correct any such inaccuracy. Subsequent changes in circumstances may occur at any time and may impact the accuracy of the information. Stock opinions and views expressed in this document are Ellerston Capital's and are not necessarily the views or opinions of the market. To the full extent permitted by law, none of Ellerston Capital, or any member of the Ellerston Capital Limited Group of companies makes any warranty as to the accuracy or completeness of the information in this document and disclaims all liability that may arise due to any information contained in this document being inaccurate, unreliable or incomplete.